

**Small Business/Self-Employed Division
Management Needs to Increase Staffing
Commitments to Meet Its Electronic Filing
Mission**

May 2003

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

May 12, 2003

MEMORANDUM FOR ACTING COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report –Small Business/Self-Employed Division
Management Needs to Increase Staffing Commitments to Meet
Its Electronic Filing Mission (Audit # 200230049)

This report presents the results of our review of the organizational realignment of Electronic Tax Administration (ETA) operations to the Small Business/ Self-Employed (SB/SE) Division. The overall objective of this review was to determine whether the risks inherent in the realignment have been adequately managed by the SB/SE Division to enable the missions of the transferred functions to be met.

The Commissioner, SB/SE Division, identified the organizational realignment of former ETA responsibilities to the Division as one of the top three areas for Treasury Inspector General for Tax Administration audit coverage in Fiscal Year 2003.

In summary, the SB/SE Division had successfully assimilated several ETA functions since assuming responsibility for operational electronic products beginning in June 2002. The ETA's Electronic Business Returns and Payment Products and Services functions were consolidated into one function within Customer Account Services, and the ETA's Business Marketing Services function became part of Taxpayer Education and Communication. Also, in order to monitor progress toward the attainment of e-filing goals, the SB/SE Division had established an acceptable performance measure to determine the number of electronically filed business returns.

However, achieving mission goals could be in jeopardy unless staffing is increased. SB/SE Division management created a high level E-Submissions Steering Committee that had identified understaffing as a risk to meeting mission goals and was working to provide the e-functions the resources necessary to meet additional operating and marketing responsibilities that accrue as newly developed e-forms are received.

We recommended that the Commissioner, SB/SE Division, consider re-allocating Division resources commensurate with the high priority placed on the *e-file* initiative through the Administration's Government to Business E-Government Strategic Goals, as well as Congressionally mandated goals. The Commissioner should request additional resources through the Congressional Justification and Budget Request process if re-allocation of SB/SE Division resources is not feasible.

Management's Response: Internal Revenue Service (IRS) management agreed with the recommendations. A reorganization of the Electronic Business Return/Payment Products and Services function was approved to immediately add seven positions to support e-file operations. The SB/SE Division's E-Submissions Executive Steering Committee initiated a Trends, Issues and Problems (TIP) initiative in the strategic planning cycle that resulted in an SB/SE Division strategy related to E-Submissions growth. The Drivers of Program Resources accompany this TIP, requesting additional resources for electronic programs within the SB/SE Division.

Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Richard J. Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (631) 654-6028.

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Background

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)¹ included e-filing goals. The Congress mandated goals requiring that 100 percent of computer prepared tax returns be electronically filed (e-filed) by 2003, and 80 percent of all tax returns be e-filed by 2007. The Internal Revenue Service (IRS) subsequently developed the Electronic Tax Administration (ETA) Strategy that established a framework for accomplishing these e-filing goals. The ETA Strategy is important to generating cost savings by reducing both processing expenses and the burden on taxpayers through simplifying the filing of tax returns.

Beyond the RRA 98 goals are the President's Management Agenda initiatives that include expanding electronic government. The Administration's E-Government Strategy included initiatives to expand Government to Business Services through electronic tax products for businesses. When implemented, the initiatives are projected to reduce the burden of compliance by saving each small business up to \$182 per year. Aggregated, small businesses stand to save up to \$6.4 billion over 6 years. Additional benefits include increases in the accuracy and reliability of tax data, as well as reducing or eliminating the costs associated with paper processing. Other benefits expected are annual savings to the IRS and Social Security Administration (SSA) of \$16 million in staff and printing/mailing costs, and reductions of 5.6 percent in the costs to states for processing wage and tax data.²

To better focus on core customer needs, starting in June 2002, the IRS' Business Operating Divisions³ assumed responsibilities for operational electronic products for their respective customer segments. The Commissioner, Small Business/Self-Employed (SB/SE) Division, identified the

¹ Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² E-Government Strategy, February 27, 2002.

³ Per the RRA 98, the IRS reorganized into four operating divisions to focus on serving specific taxpayer groups.

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organizational realignment of former ETA responsibilities to the SB/SE Division as one of the top three areas that he wanted the Treasury Inspector General for Tax Administration to include in its Fiscal Year (FY) 2003 Audit Plan.

Audit work was performed at the SB/SE Division National Headquarters in New Carrollton, Maryland, from September 2002 through January 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The Transferred Functions Were Successfully Assimilated and Performance Measures Were Effectively Established

The transferred functions were successfully assimilated by the SB/SE Division

The recent organizational realignment of ETA responsibilities has affected the SB/SE Division by transferring the Business Marketing Services function to the Taxpayer Education and Communication function, where it became the Office of Electronic Programs effective November 1, 2001. The overall mission of the Office of Electronic Programs is to develop the marketing vision and strategy for implementing the e-file for business program and the Electronic Federal Tax Payment System.

The Electronic Business Returns and the Payment Products and Services functions were transferred to the Customer Account Services function, where they were subsequently merged into one function effective June 30, 2002. The overall mission of the renamed Electronic Business Returns/Payment Products and Services is to have all SB/SE business returns available electronically. This function is responsible for testing the electronic forms delivered by the ETA and assuming all responsibilities for implementation. They also provide taxpayers with all available payment technology.

The SB/SE Division successfully assimilated these functions as transferred from the ETA, with all existing staffing and access to funding and training resources. Missions and milestones were successfully addressed as follows:

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- The Office of Electronic Programs function successfully aligned its specific mission to the needs of the internal and external users. It is also responsible for servicing research requests from the other Business Operating Divisions.
- The Electronic Business Returns/Payment Products and Services function successfully re-aligned its specific mission to the needs of the internal and external users.
- The Office of Electronic Programs established a milestone table to monitor deliverables as set forth in the Statement of Work for the national marketing campaign.
- The ETA, Wage and Investment Division, retained program responsibility for monitoring milestones for electronic business returns during the development and testing phases.

A performance measure was established

The SB/SE Division has successfully implemented a performance measure in accordance with the Government Performance and Results Act's (GPRA)⁴ requirements, to provide counts of the total business returns filed electronically. The data dictionary⁵ accurately defines the performance measure, and computer programs verify and validate volumes of electronically filed business returns.

⁴ Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.). The GPRA was enacted to address concerns about government accountability and performance. The GPRA requires federal agencies to define organizational goals and performance measures, and submit to the Congress strategic and annual performance plans.

⁵ The IRS defines its critical performance measures in its data dictionary. The definitions detail what data are included in each performance measure. The data dictionary also identifies any limitations that the IRS has identified with the data. The IRS associates this dictionary with its annual performance plans and makes it available on its public web site.

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We reviewed the formula and methodology supporting the performance measure and found that the electronically filed forms were processed at several IRS locations to various data files. These data files are subject to strict balancing routines, in accordance with IRS practices, to accurately validate and verify volumes. In our opinion, the methodology for identifying volumes of electronically filed business returns is sound.

Presently, this performance measure consists of volumes, which are manually recorded from electronic reports produced for each type of electronic business return filed at one of several field locations. This information is forwarded to the SB/SE Division Headquarters to be summarized for reporting purposes. An effort is underway to automate the entire process and should be completed during 2003.

Understaffing and Increasing Workloads Threaten the Effectiveness and Missions of the Transferred Functions

SB/SE Division management is responsible for defining needs, identifying risks, and providing sufficient resources to minimize the risks in accomplishing the missions of the transferred functions. However, with the addition of new e-forms, staffing resources are not adequate to enable the transferred functions to meet their increasing responsibilities.

Since moving to the SB/SE Division, the Electronic Business Returns/Payment Products and Services function has documented the need for eventual expansion from 23 to 42 positions, once all business returns are made available electronically. Seven of these positions are needed immediately to meet program objectives, and two positions will be needed in the next fiscal year. However, no further positions have been received.

Since moving to the SB/SE Division, the Office of Electronic Programs function has documented the need to expand from 13 to 20 positions, once all business returns are made available electronically. Four of these positions are needed immediately to meet program objectives. However, no further positions have been received, and a vacant position needs to be filled.

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The Director of ETA indicated that staffing resources were inadequate to achieve mission objectives even prior to the function transfers. The ETA had requested additional resources in the FY 2003 Congressional Justification and Budget document, and three positions are now in the process of being moved from the ETA to the SB/SE Division.

The FY 2004 Congressional Justification and Budget document submitted by the IRS did not contain a request for additional resources. Also, neither the SB/SE Division's Strategy and Program Plan for FY 2003 – FY 2004, nor the Annual Performance Plan for FY 2004, contain any mention of the need for additional e-file resources.

SB/SE Division management recently created a high level E-Submissions Steering Committee responsible for providing oversight and guidance related to the E-Submissions priority within the SB/SE Division's strategic plan. This committee recently opened a Trends, Issues, and Problems (TIP) initiative to address and resolve the concern regarding insufficient growth in staffing resources needed to meet the long-term mandated goal of having 80 percent of all tax returns filed electronically by 2007.

In addition, SB/SE Division management is in the process of requesting permission to fill an existing position that is presently vacant within the Office of Electronic Programs. There are also internal efforts being made to incorporate additional resources within Electronic Business Returns/Payment Products and Services. However, until additional resources are available, understaffing may:

- Jeopardize the missions of the transferred functions.
- Cause delays in meeting the Congressionally mandated e-file goal.
- Cause delays in meeting the Government to Business E-Government Strategy goals established by the President.
- Delay the positive impact of e-file services for taxpayers and tax practitioners.

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- Delay cost saving benefits to the IRS, the SSA, and state and local governments.

Recommendations

The Commissioner, SB/SE Division, should consider:

1. Re-allocating SB/SE Division resources commensurate with the high priority placed on the e-file initiative through Government to Business E-Government Strategic Goals, as well as Congressionally mandated goals.

Management's Response: A reorganization of the Electronic Business Return/Payment Products and Services function was approved to immediately add seven positions to support e-file operations.

2. Requesting additional resources through the Congressional Justification and Budget Request process if re-allocation of SB/SE Division resources is not feasible.

Management's Response: The SB/SE Division's E-Submissions Executive Steering Committee initiated a TIP initiative in the strategic planning cycle that resulted in an SB/SE Division strategy related to E-Submissions growth. The Drivers of Program Resources accompany this TIP, requesting additional resources for electronic programs within the SB/SE Division.

Detailed Objective, Scope, and Methodology

The overall objective was to determine whether the risks inherent in the organizational realignment of Electronic Tax Administration (ETA) operations to the Small Business/Self-Employed (SB/SE) Division were adequately managed to enable the missions of the transferred functions to be met. To accomplish our objectives, we:

- I. Determined whether the transferred functions remained fully funded to support e-filing and e-payment programs.
 - A. Obtained budget information from the ETA for functions transferred to the SB/SE Division.
 - B. Obtained budget information from the SB/SE Division for functions transferred from the ETA.
 - C. Compared budget information obtained in steps I. A. and I. B. to determine whether the SB/SE Division received full funding.
- II. Determined whether transferred functions were fully staffed and trained.
 - A. Obtained organization chart information from the ETA for functions transferred to the SB/SE Division.
 - B. Obtained organization chart information from the SB/SE Division for functions transferred from the ETA.
 - C. Compared organization chart information obtained in steps II. A. and II. B. to determine whether the SB/SE Division received full staffing.
 - D. Determined the extent of training needs for transferred functions and whether training had been received or scheduled.
- III. Determined whether milestones were established to ensure that e-file and e-payment programs and policies were being achieved.
 - A. Interviewed the manager of the Electronic Business Returns/Payment Product and Services function to determine what milestones had been set for developing e-forms and payment options.
 - B. Interviewed the manager of the Office of Electronic Programs to determine what milestones had been set for implementing marketing strategies.
 - C. Interviewed the ETA Director of Diversified Electronic Filing to determine responsibility for the coordination of the development of e-file forms between the

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SB/SE Division and the ETA function within the Modernization, Information
Technology and Security Services organization.

- IV. Determined whether the specific missions of the transferred functions were identified and aligned to the needs of the internal and external users.
 - A. Interviewed the manager of the Electronic Business Returns/Payment Product and Services function to identify its mission and internal and external users. Determined whether the specific needs of the internal and external users were being met.
 - B. Interviewed the manager of the Office of Electronic Programs to identify its mission and internal and external users. Determined whether the specific needs of the internal and external users were being met.
- V. Determined the reliability of the performance measures for Electronic Business Returns Filed.
 - A. Identified the data definition for measuring Electronically Filed Business Returns.
 - B. Determined what verification and validation routines IRS performed for ensuring the accuracy of the performance measure.
 - C. Based upon steps V. A. and V. B., formed an opinion as to accuracy and completeness of the performance measure.
 - D. Interviewed the manager of the Electronic Business Returns/Payment Product and Services function to identify whether the SB/SE Division had set specific interim goals for percentages of business tax returns filed.

Major Contributors to This Report

Richard J. Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs)

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Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner N:DC
Acting Deputy Commissioner, Small Business/Self-Employed Division S
Director, Customer Account Services, Small Business/Self-Employed Division S:CAS
Director, Electronic Tax Administration, Wage and Investment Division W:ETA
Director, Taxpayer Education and Communication, Small Business/Self-Employed Division S:T
Deputy Director, Taxpayer Education and Communication, Small Business/Self-Employed
Division S:T
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaison:
Commissioner, Small Business/Self-Employed Division S

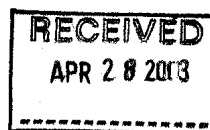
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Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224



APR 24 2003

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

Dale Hart *Dale Hart*
Acting Commissioner
Small Business/Self-Employed Division

SUBJECT:

Draft Audit Report – Small Business/Self-Employed
Division Management Needs to Increase Staffing
Commitments to Meet Its Electronic Filing Mission
(Audit # 200230049)

I reviewed your report that examined whether we adequately managed the risks inherent in the organizational realignment of the Electronic Tax Administration (ETA) operations to the Small Business/Self-Employed (SB/SE) Division. The findings reflect SB/SE successfully assimilated and established performance measures for the transferred functions. The report also shows possible delays in meeting congressionally mandated e-file goals without additional staffing. The Office of Electronic Programs (formerly Business Marketing Services) under the Director, Business Marketing Services (BMS), transferred to SB/SE effective November 1, 2001. This office's mission is to develop the marketing strategy for implementing the e-file for business program and the Electronic Federal Tax Payment System (EFTPS). Since moving to the SB/SE Division, the Office of Electronic Programs has effectively provided nationwide research and marketing strategies resulting in a significant increase in business e-file. We have also incorporated EFTPS strategies into partnerships with financial institutions, which have significantly impacted electronic payments.

The Electronic Business Return Operations and E-Payment Products function, under the Director, Submission Processing (Customer Account Services), transferred to SB/SE effective June 30, 2002. This office's mission is to advise the Director, Customer Account Services (CAS) on matters relating to electronic commerce for electronic returns, e-payments and electronic information documents submissions, and processing and distribution. Since moving to SB/SE, this function has successfully assumed responsibility for the legacy e-filing process and customer segments for employment taxes, successfully transitioned numerous businesses from Philadelphia Submission Processing to a more secure environment without increases to the paper return volumes, and

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have successfully initiated many innovative payment options. In 2003, we enabled the 94X forms and 1041 returns and expanded electronic payments to International taxpayers and domestic on-line banking. In 2004, we will enable 1120, 1120S, and 990 forms and begin phasing out paper checks processing in favor of e-payment options.

In light of the Congressional mandate of 80% e-file by 2007 and the continued development of electronically enabled business returns, the recommendation for additional staff would enhance our ability to meet this goal.

RECOMMENDATIONS 1 and 2:

The Commissioner, SB/SE Division, should consider:

1. Re-allocating SB/SE Division resources commensurate with the high priority placed on the e-file initiative through Government to Business E-Government Strategic Goals, as well as congressionally mandated goals.
2. Requesting additional resources through the Congressional Justification and Budget Request process if re-allocation of SB/SE Division resources is not feasible.

CORRECTIVE ACTION:

The SB/SE E-Submissions Executive Steering Committee initiated a Trend, Issue and Problem (TIP) in the strategic planning cycle that resulted in a SB/SE strategy related to E-Submissions growth. The Drivers of Program Resources (DRIP) accompany this TIP, requesting additional resources for electronic programs within SB/SE.

I have also approved a reorganization of the Electronic Business Return Operations and E-Payment Products function that would immediately add seven positions to support the 1065 and 1041 e-file operations and to begin the transition of operational responsibility for new e-payment products and the 1120 and 990 e-file product lines to SB/SE.

IMPLEMENTATION DATE:

September 30, 2003

RESPONSIBLE OFFICIAL:

Commissioner, Small Business/Self-Employed Division

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CORRECTIVE ACTION MONITORING PLAN:

The Director, Taxpayer Education and Communication, Small Business/Self-Employed Division and the Director, Customer Account Services, Small Business/Self-Employed Division will monitor the corrective actions.

If you have any questions please, contact me at (202) 622-0600 or Bobby Hunt, Director, Office of Taxpayer Education and Communication, Small Business/Self-Employed Division at (202) 283-2627.